

The U.S. Economy in 1973

INFLATION was severe in 1973 but on other counts the record of the U.S. economy for the year as a whole was favorable. There was a large increase in real output, an exceptionally large rise in employment that was reflected in a substantial decline in the unemployment rate, and sizable advances in profits and personal income. During the year, however, the growth of production and employment was slowing. Some of the deceleration, especially in the spring and summer, was due to capacity constraints and shortages of key materials, but toward yearend it seemed clear that a general economic slowdown was underway, and the consensus of forecasts looked to much weaker expansion in 1974 than in 1973. In the year's final months, employment growth stopped, the unemployment rate moved up, consumer demand was flat, and aggregate output increased very little. The boycott by Arab oil producers, and the steep rise in world petroleum prices—including prices set by non-Arab producers—introduced new uncertainties as 1973 drew to a close. The boycott probably intensified the drop in auto sales in the fourth quarter, but the impact on the U.S. economy of the boycott and higher prices was still largely in the future when the year ended.

Inflation was the most serious problem facing economic policymakers last year. The wholesale price index rose almost 14 percent from 1972 to 1973 and the consumer index 6 percent, the steepest increases since World War II. Higher prices for food and petroleum products were major contributors to the inflation. The increase in agricultural prices mainly reflected the shortness of supplies caused by poor harvests abroad, augmented by the more or

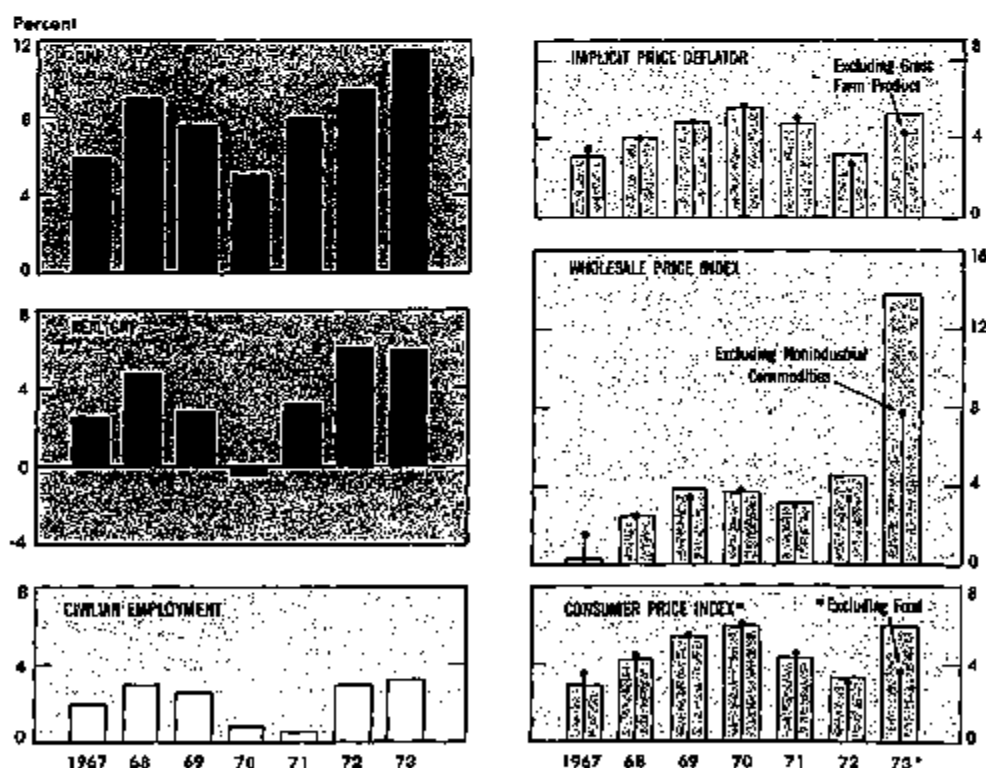
less coincident timing of booms in major world economies. Petroleum prices were already rising steeply before the actions by Arab and other producers late in the year, reflecting strong world demand and increasingly serious supply problems. The worldwide economic boom, which affected petroleum demand, was also important in boosting prices of industrial materials such as metals and lumber.

The stance of fiscal and monetary policy was in general restrictive in 1973. The Federal budget (on the na-

tional income accounts basis) swung from a deficit of \$16 billion in 1972 to a small surplus in 1973. On the "full employment" basis that is more appropriate for isolating the impact of the budget on the economy, the budget position shifted somewhat less sharply, from a deficit of \$6 billion in 1972 to a surplus of \$8½ billion in 1973. The "full employment" budget position moved from deficit in late 1972 to surplus in the first half of 1973, and the surplus increased in the second half. Monetary policy turned rather clearly

CHART 6

Output, Employment, and Prices—
Percent Change From Previous Year



*1973 figures based on Jan.-Nov. average for 1972 and 1973.

U.S. Department of Commerce, Bureau of Economic Analysis

restrictive late in 1972, and in 1973 all the major monetary policy tools were used in an effort to moderate the growth of credit and thus of aggregate demand. The monetary authorities permitted steep increases in interest rates to restrain the demand for credit and allocate credit among prospective borrowers. This contrasted with other periods of credit restraint in recent years, when the authorities did not allow interest rates to rise so much and operated more through directly curtailing the ability of banks and other intermediaries to lend.

The Government's economic stabilization program, which had its origin in the temporary wage-price-rent freeze of August 1971, underwent several shifts in 1973. In mid-January, "Phase III" was introduced. It greatly reduced the requirements for reporting and prior approval of wage and price changes, and was intended as a major step toward removal of the controls program. During the first half of 1973, however, various factors—led by developments in world markets for agricultural products and industrial materials—caused prices to rise sharply, and this engendered considerable sentiment for some sort of Government action on prices. As a consequence, a price freeze was imposed in mid-June, intended to allow time for development of a new system of controls which ultimately came into being as "Phase IV." This system marked a return to a rather extensive control mechanism with considerable requirements for reporting and clearance. As the year progressed, however, the administration was moving quite rapidly to remove the controls on an industry-by-industry basis.

Pressures on productive capacity, especially in manufacturing, were unusually widespread last year. The reasons are numerous. The more or less coincident timing of booms in major world economies was a factor, as was the stimulus to demand for U.S. output engendered by the dollar devaluations and the revaluations of other major currencies over the past several years. Moreover, prior to those exchange rate adjustments the dollar had been appreciably overvalued, and the resulting competition from foreign-

made goods—both in U.S. markets and abroad—probably dampened capacity expansion in some U.S. industries several years ago. Market distortions arising from the imposition of price controls may also have dampened investment in recent years. The Federal Reserve measure of capacity utilization in major materials industries (which was publicly released for the first time last summer) showed a 96 percent utilization rate in the third quarter of 1973. That was the highest rate in the history of the series, which goes back to 1948. Limits on the expansion of these industries' production had ramifications throughout the economy, particularly in the second half of the year.

Taking into account the strong demand for labor in 1973 and the sharp rise in prices, labor relations were relatively tranquil. Close to 5 million workers were affected by union contracts that expired or were subject to reopening, making 1973 a relatively heavy bargaining year. However, there were no major strikes, and the percentage of potential working time lost in work stoppages was apparently lower than in 1972, which was a lighter bargaining year. Wage increases negotiated in major contracts in 1973 were lower than those negotiated in each of the preceding 3 years. First-year increases in straight time hourly earnings averaged 6 percent in contracts settled in the first 9 months of last year, and increases over the life of the contract averaged 5½ percent. Those figures were, respectively, 1½ percentage points and 1 percentage point below the average settlements in 1972. However, many workers receive wage increases under cost-of-living clauses tied to the consumer price index, in addition to the increases specified exactly in the contracts. The number of workers covered by such clauses has risen sharply, to somewhat more than 4 million last year compared with 2.8 million in 1970 and 2 million in the mid-1960's. The rapid rise in the consumer price index last year, plus the fact that some contract settlements liberalized the cost-of-living formulas, suggests that wage increases resulting from escalator clauses were considerably larger last year than in 1972.

Output and prices

The Nation's total output of goods and services in 1973 had a value in current prices of \$1,288.2 billion, up \$133.0 billion or 11½ percent from 1972 (table 1). Price inflation accounted for about half of the rise in the nominal value of output; GNP in constant prices increased about 6 percent from 1972 to 1973, while the implicit price deflator for GNP increased 5½ percent (chart 6). Residential investment weakened through the year and showed little gain from 1972 to 1973 even in current prices; in constant prices it declined. Similarly, Federal Government spending increased only modestly and in real terms declined. Inventory investment was very low—below the 1972 pace—through most of 1973 but seems (on the basis of partial data) to have moved to a much faster rate in the year's closing months. Other major demand sectors recorded sizable increases in 1973. By far the strongest increase was in foreigners' demand for U.S. output. Business capital investment and spending by State and local governments also rose sharply. The increase in consumer spending was larger than in 1972 but this reflected inflation; in real terms, growth of consumer demand, although large, was slower than in 1972.

A substantial part of last year's price acceleration can be traced to farm prices. The implicit deflator for gross farm product rose 47 percent, compared with 19 percent in 1972; thus, the rise

Table 1.—Percent Change in Major Components of GNP

	1971	1972	1973
GNP	6.8	5.4	11.5
Final demand ¹	7.0	6.6	11.5
Personal consumption expenditures.....	8.0	8.0	10.9
Autos.....	28.4	11.3	8.6
Other durable goods.....	7.7	14.4	13.1
Food.....	5.1	5.4	11.1
Gas and oil.....	5.9	8.5	13.7
Other nondurable goods.....	6.3	3.5	12.0
Services.....	8.5	6.6	0.2
Business fixed investment.....	3.5	13.2	15.1
Residential investment.....	26.0	26.3	7.4
Exports of goods and services.....	5.4	10.9	37.6
Imports of goods and services ²	10.4	10.2	23.8
National defense purchases.....	-4.0	3.9	-3
Other Federal purchases.....	22.7	13.6	8.8
State and local government purchases.....	10.8	10.5	13.2

1. GNP less inventory accumulation.
2. Gross imports are subtracted from the sum of other demand components in the calculation of GNP.

in the nonfarm deflator accelerated less than the rise in the overall deflator (chart 6). Excluding not only farm product but also general government output, the implicit deflator for the private nonfarm economy rose 4.0 percent in 1973, compared with 2.8 percent in 1972 and 4.4 percent in 1971.

Food prices in the consumer price index averaged 14 percent higher in 1973 than in 1972, compared with a rise of less than 4½ percent from 1971 to 1972. Excluding food, the consumer price index rose 3½ percent last year compared with 3 percent in 1972 (chart 6). Rising fuel prices did not have a marked direct influence on the consumer index last year, because their weight in the index is low.

The wholesale price index rose nearly 14 percent in 1973, compared with 4½ percent in 1972. The index for farm products and processed foods and feeds rose at an extraordinary rate through midsummer, then declined; for the year as a whole, it was up 30 percent, compared with 7½ percent in 1972. The index for fuels and related products recorded its steepest advance in the closing months of the year but had also shown substantial increases before then. It was up 22½ percent last year, compared with 4 percent in 1972. Excluding farm and food prices, the wholesale index rose 7½ percent in 1973, compared with 3½ percent in 1972 (chart 6). Excluding not only these products but also fuels, the wholesale index rose 5 percent last year and 3½ percent in 1972.

Productivity and unit costs

Output per man-hour in the private economy increased only about 2½ percent last year, down from about 4 percent in 1972 and 1971. The slowdown was about the same excluding the relatively small, but often volatile, part of total output produced by the farm sector: output per man-hour in the private nonfarm economy increased about 3 percent last year, down from about 4 percent in 1972 and 1971. The slowing of productivity growth during the course of last year reflected both the employment of less efficient labor and equipment resources, as capacity utili-

zation rose to high levels, and the typical cyclical pattern in which business is slow to adjust man-hours when economic activity begins to slow down.

In both the overall private economy and its nonfarm sector, the rise in compensation per man-hour accelerated from just under 7 percent in 1972 to 7½ percent in 1973. Consequently, unit labor cost increased much more last year than in either of the preceding 2 years. Unit labor cost moved up about 4½ percent in the private economy as a whole and about 4½ percent in the nonfarm sector. Part of last year's acceleration of both compensation per man-hour and unit labor cost reflected the increase in contributions for social insurance effective last January. One-half of the social security tax is paid by the employer, and this payment is counted in the measure of employee compensation; in January, the maximum amount of earnings subject to the tax was raised from \$9,000 to \$10,000 and the combined employer-employee tax rate from 10.4 percent to 11.7 percent.

Corporate profits

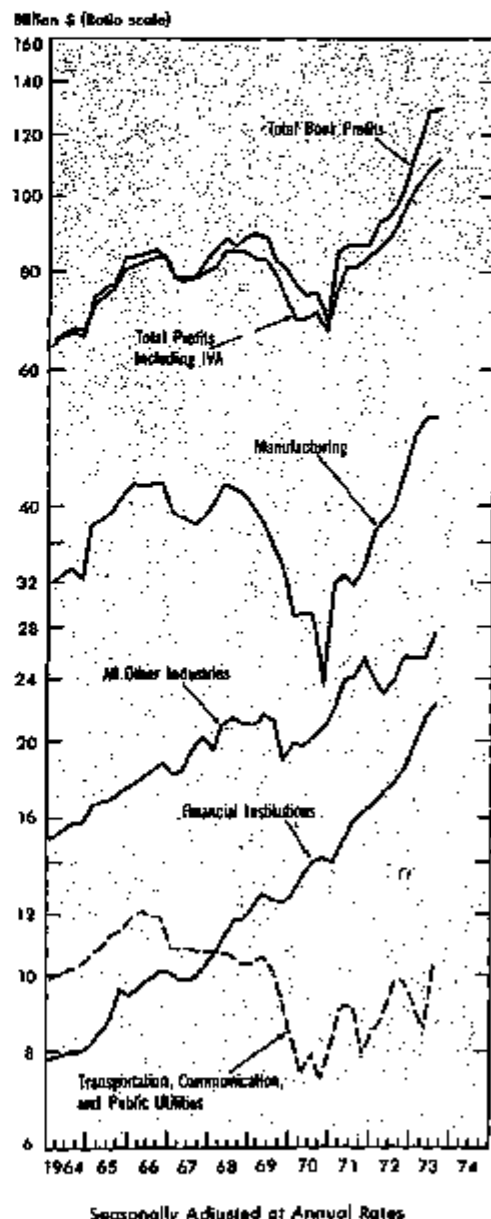
Despite the faster increase in labor cost per unit of output nonfinancial corporations' profit per unit rose considerably more last year than in 1972. On the basis of preliminary data, profit per unit of output was up about 10 percent last year, compared with 6 percent in 1972. With the corporations' total output—i.e., value added—rising slightly faster last year, the increase in their total profits was much larger than in 1972. Pretax profits from domestic operations, as measured in national income, i.e., excluding inventory profits, increased about 18½ percent, compared with 13½ percent in 1972. The profits expansion last year was almost entirely in manufacturing (chart 7). Pretax profits of manufacturers were up 29 percent but other domestic nonfinancial industries showed little if any profit gain. However, profits of financial corporations increased sharply (chart 7) as did profits remitted from abroad (which are included in the "other industries" category on the chart). Profits remitted from abroad

are counted in the overall national income measure of profits, as an income to U.S. owners of capital invested abroad. Total pretax profits, on the national income basis, are preliminarily estimated for the year at \$109½ billion, up \$18 billion or 20 percent from 1972. The rise from 1971 to 1972 was 13½ percent.

The book profits of corporations were sharply inflated in 1973 by in-

CHART 7

Corporate Profits Before Taxes



Note.—All data except total book profits are on national income basis, i.e., including inventory valuation adjustment where applicable.

ventory profits arising from differences between the replacement cost of goods taken out of inventory and the cost at which they are charged to production. Such profits arise when prices are increasing, and they must in effect be used for inventory restocking if the physical volume of inventories is not to decline. Because such profits are not generated by current production activity, they are excluded from the profits component of national income. BEA estimates that the inventory profits of nonfinancial corporations—represented by the inventory valuation adjustment in the national income accounts—were \$17½ billion in 1973 compared with \$7 billion in 1972. Book profits before taxes, including the inventory profits, were \$126½ billion last year, up from \$98 billion in 1972 (chart 7).

International accounts

U.S. international transactions in trade and services showed a surplus of \$4½ billion last year, a steep turnaround from the \$4½ billion deficit into which the trade and services accounts had plunged in 1972. There was also a dramatic shift in long-term capital flows. (The trade and services estimates for the fourth quarter are tentative, and for other international flows no fourth quarter estimates are yet available). As a result, the "basic balance"—the balance on current account and long-term capital—was in surplus by \$1.3 billion (seasonally adjusted annual rate) in the first three quarters of 1973 and it is likely that the account for the year as a whole will show a surplus. In 1972, the basic balance was in deficit by \$9.8 billion.

The improvement in trade and services reflected strong world demand, especially for agricultural commodities, industrial materials, and capital goods, as well as the price effects of faster inflation abroad than in the United States and of the dollar's depreciation against major currencies in the past 2 years. The dollar was devalued in December 1971 and February 1973, and many other currencies were formally revalued or permitted to rise against the dollar in the system of

floating exchange rates adopted early in 1973.

Some outflows of long-term U.S. capital early last year, especially through transactions between U.S. parent firms and their direct investment affiliates abroad, were stimulated by expectations of further depreciation of the dollar. For the first three quarters, direct investment capital outflows were up substantially from 1972. This was more than offset, however, by an increased inflow of foreign capital for direct investment and for the purchase of U.S. securities. Also, the outflow of U.S. capital for the purchase of foreign securities was much smaller in 1973 than in 1972. In total, long-term capital transactions showed a net inflow for the first three quarters of 1973 of almost \$1 billion (seasonally adjusted annual rate), a contrast to the more usual net outflow; the outflow for the year 1972 was \$1.5 billion.

Recorded and unrecorded outflows of short-term capital increased from 1972 to 1973. The increase was concentrated in last year's first quarter, when heavy outflows were stimulated by exchange market uncertainties (which culminated in the February devaluation of the dollar and the floating of several leading currencies against the dollar). Despite renewed exchange market pressure in

the summer, short-term capital flows improved on balance after the first quarter. Nevertheless, the year's first three quarters showed an outflow that was very much larger than in 1972. This offset most of the shift in the basic balance, so that the official reserve transactions balance for the first three quarters was still in heavy deficit—although it moved into surplus on a quarterly basis as the year progressed. The official transactions deficit through September was \$8.1 billion—\$10.7 billion at an annual rate—compared with \$10.3 billion for the full year 1972.

The adoption of floating exchange rates for the dollar and other leading currencies early last year affects the interpretation of the official balance. Under fixed rates, exchange market pressures against the dollar were reflected mainly in increases in U.S. liabilities to foreign official agencies and thus a deficit on the official reserve basis, for the foreign agencies would intervene via purchases of dollars to maintain their exchange rates within prescribed limits. Under floating rates, exchange market pressures should be mainly reflected in changes in exchange rates, and in the absence of intervention the official balance should approach zero.

Financial Developments

THE monetary authorities set a restrictive policy course in 1973, in an effort to curb very strong credit demands and to restrain inflationary pressures. The move toward tighter credit was gradual in the early months of the year, as the authorities apparently sought to slow the growth of the monetary aggregates (the money stock, reserves, etc.) without sharp increases in interest rates. However, a slowing of the growth of the aggregates early in the year, which was due in part to transitory factors, was followed by acceleration, and the emphasis of policy shifted in the second quarter toward much more aggressive restraint.

Very tight conditions prevailed in money and credit markets from mid-spring through the summer; short-term interest rates reached levels well above the record highs of 1969 and early 1970 (chart 8) and the growth of the monetary aggregates slowed (table 2). Indeed, the money stock (currency in circulation and private demand deposits) actually declined slightly in both August and September, after having increased at a 5.9 percent seasonally adjusted annual rate in the first 7 months of last year. Credit policy was somewhat less restrictive in the closing months of the year, and short-term interest rates declined

Table 2.—Change in Money Aggregates¹
(Percent, seasonally adjusted at annual rate)

	1972				1973			
	I	II	III	IV	I	II	III	IV
Money stock (M ₁).....	9.2	0.1	8.2	8.8	1.7	10.3	0.3	7.9
Money stock plus time deposits at commercial banks other than large CD's (M ₂).....	12.7	8.0	10.8	10.2	3.7	0.6	5.1	10.2
M ₂ plus deposits at nonbank credit institutions (M ₃).....	14.9	10.7	12.4	11.5	5.6	0.4	4.4	9.3

1. Changes calculated between end-of-quarter months.

Source: Federal Reserve Board.

appreciably from their summer highs while several of the major monetary aggregates were again expanding briskly.

Monetary policy

The Federal Reserve System used all of its major credit policy tools last year. Open-market operations were employed to restrict the growth of bank reserves, and thus of money and credit. The reserve requirement on demand deposits in excess of \$2 million was raised one-half of 1 percent, and the reserve requirement on further expansion of large negotiable certificates of deposit (CD's) was twice raised, in May and in September, by 3 percent each time. (The second increase was rescinded in December.) Also, the discount rate was raised from 4½ percent to 7½ percent, in seven steps. Some of the increases were described by the Federal Reserve as actions taken to simply close the differential between the discount rate and rising market interest rates, while some were explicitly described as intended to curb excessive expansion in money and credit.

Credit restraint in 1973 differed in a significant way from that of 1966 and 1969. Last year the Federal Reserve System relied almost exclusively on its general tools of credit control to affect the cost and availability of credit and did not rely on Regulation Q ceilings, which govern the rates commercial banks can pay on time and savings deposits. Rate ceilings on short-maturity CD's were suspended in 1970 and on longer term CD's in May of last year. In both 1969 and 1966, market interest rates rose far above Regulation Q ceilings and depositors shifted funds

from banks to direct investment in open market instruments. Because Regulation Q controls prevented banks from effectively competing in money markets for loanable funds, their role as intermediaries in the credit flow process contracted.

The fact that commercial banks last year could aggressively compete in money markets for loanable funds through sales of CD's added considerably to the rise in money market interest rates. However, although funds were progressively costlier and harder to get through the first 9 months of the year, they were available to borrowers and the role of commercial banks in the credit process was not severely constrained as it had been in 1969 and 1966. The commercial banking system accounted for 38 percent of total funds advanced in credit markets in the first three quarters of last year, about the same as in 1972 when monetary policy was accommodative or only mildly restrictive. This is in sharp contrast with the situation in 1969; in that year, banks accounted for only 15 percent of total funds advanced in credit markets, as compared with 34 percent in 1968. Thus, a major effect of suspending Regulation Q ceilings on large CD's was to permit banks to maintain their position in the credit process and allow interest rates to function much more freely as the allocator of credit.

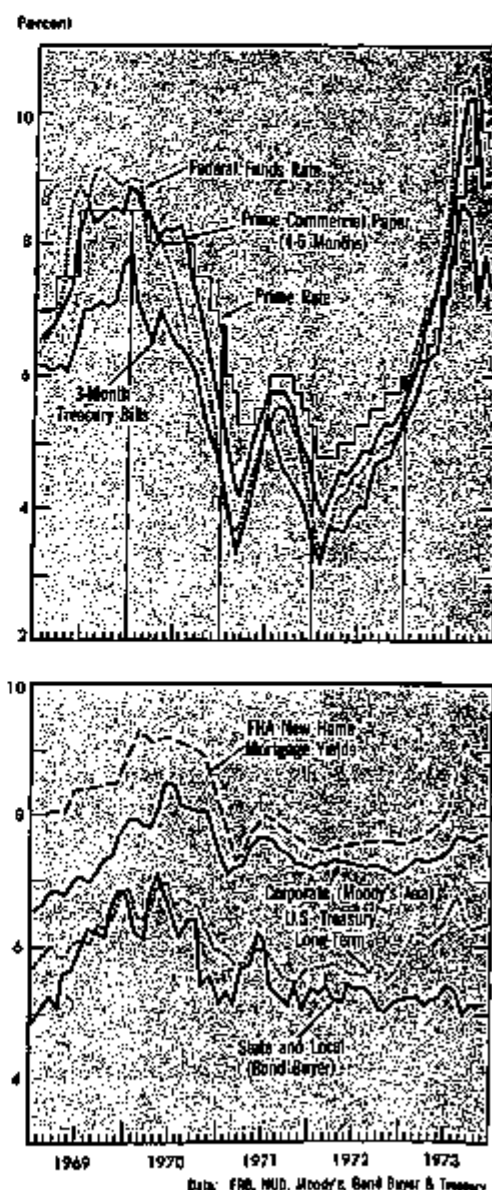
Interest rates

Restrictive monetary policy and very strong short-term credit demands resulted in a sharp escalation of money market interest rates through the first three quarters of last year. The federal funds rate—the price at which banks

buy and sell excess reserves, and a barometer of Federal Reserve Policy—increased nearly 5½ percentage points to 10½ percent during the first 9 months of 1973. The rate on prime commercial paper increased nearly 5 percentage points to 10½ percent, and the prime commercial loan rate was raised from 6 percent to 10 percent in 16 steps. Most of the increase in the prime rate occurred after May; earlier in the year, it lagged after other money market rates as the Government's Committee on Interest and Dividends tried to induce

CHART 8

Short- and Long-Term Interest Rates



the banking system to slow the increase in the cost of credit, and focused its attention on the very visible prime rate.

In September, business loan demand began to weaken and expectations developed in the financial community that monetary policy would be relaxed. As a result, money market rates declined sharply, then moved erratically during the fourth quarter. At yearend, most market rates were 1 to 1½ percentage points below their September highs.

Despite the escalation of short-term rates, long-term rates moved little until the summer and even then the increase was moderate. After September, most long-term rates showed little change or declined. An exception was mortgage market rates, which began to move upward early in the year and which rose sharply in the summer months as deposit drains at the thrift institutions further threatened the availability of mortgage funds. Mortgage rates eased a little after September, but at yearend were about 1 percentage point above midyear levels. Yields on U.S. Government long-term bonds also rose sharply in the summer reflecting an early August sale of a 20-year bond. Yields on Government bonds declined after August and at yearend were about at their mid-year level.

Demands for credit

Borrowing by the nonfinancial sectors of the economy was substantially greater last year than in 1972. Total funds raised in credit markets by these sectors amounted to \$186 billion at a seasonally adjusted annual rate in the first three quarters of the year (data are not available for the fourth quarter), compared to the previous record of \$166 billion in 1972 (table 3). The increase reflected heavier borrowing by business, households, and foreigners which more than offset a reduction in borrowing by the Federal and State and local governments.

Borrowing by corporate and non-corporate business accelerated in 1973. Although corporations continued to generate a large volume of internal funds, they remained heavily dependent on external sources to finance larger capital investment programs and a sub-

Table 3.—Total Funds Raised in Credit Markets by Nonfinancial Sectors

(Billions of dollars)

	1968	1969	1970	1971	1972	1973 ¹
Total.....	94.6	91.4	97.5	146.7	166.1	186.1
Nonfinancial business.....	38.8	40.4	47.4	60.1	60.4	90.7
Corporate business.....	20.4	28.7	38.9	47.3	54.2	69.6
Short-term debt.....	13.2	18.7	9.0	8.4	16.4	35.1
Bonds.....	12.9	12.0	19.8	18.8	12.2	8.9
Mortgages.....	5.7	4.6	5.2	11.4	15.6	15.7
Stocks.....	-1.4	2.4	4.9	11.7	10.0	6.8
Noncorporate business.....	8.3	10.5	8.4	12.7	14.2	21.1
Short-term debt.....	2.7	4.8	1.3	2.7	3.4	5.2
Mortgages.....	5.6	5.7	6.7	10.0	11.8	15.9
Households.....	26.6	22.2	22.9	28.8	52.3	73.7
Consumer credit.....	10.0	10.4	8.1	11.2	10.1	22.8
Other loans.....	2.8	4.5	2.1	1.9	4.3	8.2
Mortgages.....	15.7	17.4	13.9	28.3	39.8	43.7
U.S. Government.....	13.4	-3.6	12.8	20.5	17.3	8.2
State and local government.....	9.8	10.7	11.4	17.0	12.3	6.5
Foreign.....	2.8	2.9	3.0	5.7	2.8	6.8

NOTE.—Components may not add to total because of rounding.
1. First three quarters of a seasonally adjusted annual rate.
Source: Federal Reserve Flow of Funds Accounts.

stantial increase in liquid asset acquisition. The great bulk of corporate borrowing was in short-term markets, where the volume of funds raised by them was more than double that in 1972. Because of a general expectation of lower long-term interest rates in the future, many corporations were reluctant to issue long-term debt, and the volume of funds raised through bond sales was the lowest in recent years. Moreover, because of the depressed prices in equity markets in 1973, stock sales were a relatively unattractive vehicle for raising funds, and the volume of new stock issues was below that of either 1972 or 1971.

Households substantially increased their borrowing in 1973. Here too the increase in borrowing was mainly concentrated in short-term markets, although mortgage debt expansion also continued to be very rapid. Foreigners also borrowed more in U.S. credit

markets in 1973 than in 1972. That borrowing mainly took the form of bank loans and was concentrated early in the year. At that time, expectations of a further depreciation of the dollar relative to major currencies stimulated demand for dollar loans by borrowers who wanted to switch into currencies expected to appreciate, or who wanted to invest dollars in the Eurodollar market where currency turmoil had contributed to a sharp rise in interest rates.

The Federal Government borrowed only half as much in 1973 as in 1972, as the Federal budget (measured on the NIA basis) moved toward surplus following a \$16 billion deficit for the year 1972. The volume of State and local government borrowing was a little more than half as much as in 1972. The reduction of credit demands reflected the substantial improvement in the fiscal position of many of these govern-

Table 4.—Change in Loans and Investments at Commercial Banks

(Billions of dollars, seasonally adjusted)

	1973				1972			
	I	II	III	IV	I	II	III	IV
Total loans and investments.....	19.1	14.0	18.9	21.0	27.2	18.4	16.2	7.2
Loans.....	13.4	11.0	15.3	17.8	23.0	14.5	17.8	6.4
Business.....	2.3	2.0	2.8	5.6	12.1	8.4	5.8	2.8
Other.....	10.9	8.1	12.5	12.2	15.9	8.1	12.0	4.1
Investments.....	5.7	3.0	3.6	3.2	-5.8	3.9	-1.6	-0.8
U.S. Government.....	1.8	1.3	-1.7	-1.6	-1.6	1.2	-3.3	-3.1
Other.....	3.9	1.7	5.3	4.8	-4.2	2.7	1.7	2.3

Source: Federal Reserve Board.

ments resulting both from revenue sharing and from higher tax receipts associated with strong income growth.

Commercial bank credit

Loans and investments at commercial banks increased \$69 billion from the end of 1972 to the end of 1973, only a little less than the expansion in the

preceding year (table 4). The large increase in a year of restrictive credit policy reflects the Federal Reserve's decision to permit banks to compete freely for loanable funds and thus to maintain their position in the credit process.

The net increase in credit was strongest in the first quarter of the year and slowed steadily thereafter. The great bulk of the increase (\$66½ billion) was in loans, as liquidation of U.S. Government securities largely offset acquisitions of other investments, mainly State and local government securities.

Within the loan component of bank credit, the strongest increase was in business loans, which increased much faster than in 1972. Business loan growth was exceptionally fast early in the year reflecting both the rapid expansion of economic activity and the policy of the Committee on Interest and Dividends which forced the banks to hold back the prime lending rate. That policy made it more attractive to businesses to borrow from commercial banks than from alternative sources, such as the sale of commercial paper. Among other major loan components, real estate, consumer, and nonbank financial loans all rose rapidly last year, but security loans declined, reflecting in part weakness in equities markets and an increase in margin requirements that became effective in late 1972.

Savings and loan associations

Rising market interest rates led savers to divert funds from the thrift institutions. Savings flows to the S&L's were strong in the first quarter, but weakened sharply in the second and third quarters, then recovered in the fourth when market interest rates declined (chart 9).

With savings flows shrinking, the S&L's cut new lending commitments. Commitments outstanding rose very steeply for 3 years and reached a record \$21½ billion (seasonally adjusted) in February of last year;

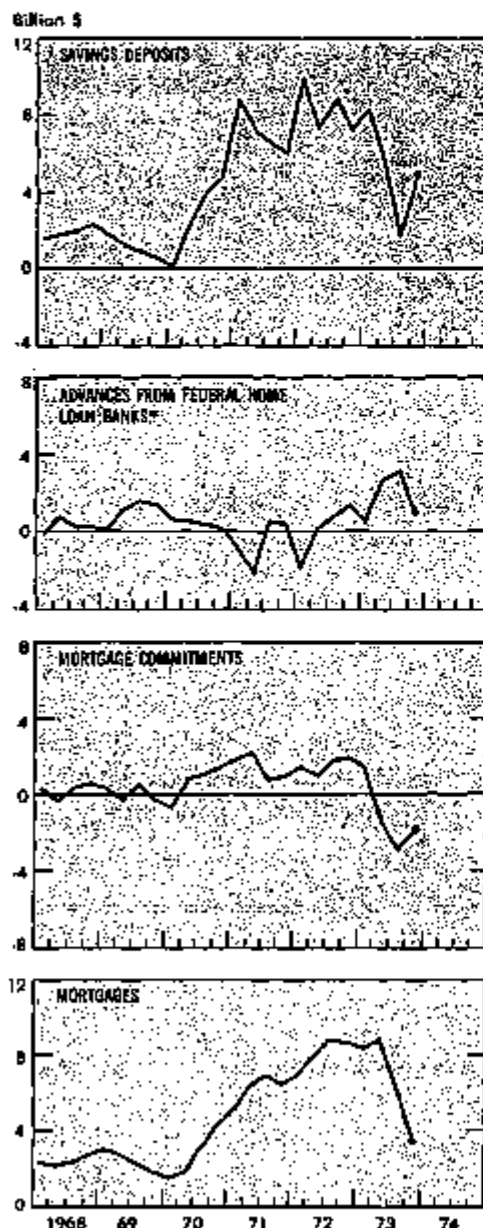
from February to November, they declined roughly 30 percent to \$15½ billion—which is still a large volume. In order to meet the high volume of outstanding loan commitments and increase the availability of mortgage funds, these institutions greatly increased their borrowing from the Federal Home Loan Banks. Outstanding FHLB advances amounted to \$14½ billion in November, about \$7 billion above the level at the start of the year.

Mortgage lending by the S&L's continued to expand rapidly in the first half of the year, but growth slowed moderately in the third quarter and sharply in the fourth. Mortgage debt holdings increased \$26½ billion, which was less than the \$32 billion increase in 1972 but the second largest volume of lending on record. Lending would probably have been even stronger if it had not been for the fact that mortgage interest rates rose above the ceilings permissible under usury laws in some States.

In addition to the support provided by the Federal Home Loan Banks, other federally sponsored credit agencies (such as the Federal National Mortgage Corporation, the Government National Mortgage Association, and the Federal Home Loan Mortgage Corporation) were actively engaged in channeling funds to mortgage markets. In the first three quarters of last year (the latest for which data are available), total support of mortgage markets (including advances by the Home Loan Banks) amounted to \$21.2 billion, about 36 percent of residential mortgage debt expansion. In providing this support, these agencies sharply stepped up their demands on credit markets, the total volume of funds raised in credit markets by these agencies amounted to nearly \$22 billion (seasonally adjusted annual rate) in the first three quarters of last year. (These agencies are included in the financial sector of the flow of funds accounts and their borrowing is therefore not included in the figures on government borrowing in table 3.)

CHART 9

Savings and Loan Associations



Change from end of quarter to end of quarter, seasonally adjusted.

* Sept. to Nov. at a quarterly rate.

** Not seasonally adjusted.

Data: FHLMG

U.S. Department of Commerce, Bureau of Economic Analysis

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Income and Consumption

PERSONAL income increased 10.3 percent in 1973 to an average for the year of \$1,035 billion, a strong advance and one considerably faster than the 8.8 percent gain in 1972. The 1978 increase would have been even larger had there not been a sharp increase in personal contributions for social insurance (deducted in the calculation of personal income). Before deduction of contributions for social insurance, income increased 10.8 percent in 1973 as compared to 8.9 percent in 1972.

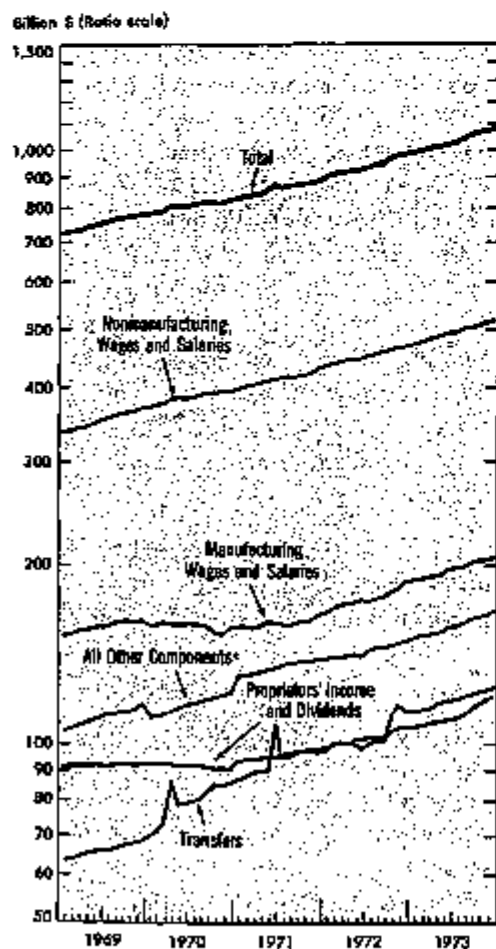
Virtually all major components of personal income increased somewhat faster in 1973 than in 1972 (table 5). The speedup in the growth of wage and salary income largely reflected unusually rapid growth of payrolls in the commodity-producing industries, particularly in the first half of the year. The big gain in these industries was due to very strong employment expansion, as hourly earnings increased at about the same rate as in 1972 and the workweek leveled off after having risen sharply in 1972. Wage and salary growth in government and in the service industries was about the same in 1973 as in 1972, and in the distributive industries a little slower. The rise in both business and professional and farm proprietors' income accelerated last year, particularly the latter, where income was boosted by the steep rise in prices of farm products. The 1973 acceleration in the growth of transfer payments reflected the 20 percent increase in social security benefits late in 1972, the extension of medicare coverage to disabled persons under 65, and a big increase in Federal pensions that reflected cost-of-living increases plus a surge in the number of retirees.

Personal income growth was stronger in second half of 1973 than in first (table 5). Wages and salaries increased

at about the same rate in the second half as in the first, and the acceleration was in other components of income. The rise in wages in the cyclically-sensitive manufacturing industries slowed appreciably after midyear, mirroring the slowdown in employment and output growth, but this was offset by a faster rate of increase in Government, where a civilian and military pay raise became effective in October, and in the service industries. Transfer payments accounted for the largest part of the acceleration of personal income after midyear, for it was in that period that the extension of medicare coverage became effective and the bulk of the increase in Federal pension payments occurred. However, growth of the other nonwage components—proprietors' income, rent, interest, and dividends—also speeded up in the second half.

Disposable personal income increased 10.7 percent in 1973, compared with 6.8 percent in 1972. The difference between disposable income growth in the 2 years is due largely to the different impact of income tax overwithholding. In 1972, new withholding schedules were introduced that resulted in some \$8 to \$10 billion of overwithholding; thus the rise in personal income from 1971 to 1972 was held down by that amount. Overwithholding continued at about the same rate in 1973 as in 1972, but there were also unusually large refunds resulting from the 1972 overwithholding; thus the rise in disposable income from 1972 to 1973 was boosted above what it "normally" would have been.

CHART 10
Personal Income



Seasonally Adjusted of Annual Rates

*Real, interest, and other labor income.

Table 5.—Percent Change in Personal Income

	1969	1970	1971	1972	1973	1st half 1973	2nd half 1973
Personal income.....	8.6	7.6	4.6	8.8	10.3	8.4	12.0
Personal income plus social insurance contributions.....	9.2	7.6	6.0	8.9	10.8	9.6	11.8
Wages and salaries, total.....	9.6	6.8	5.6	9.5	10.1	10.2	10.1
Manufacturing.....	8.0	4.4	1.4	9.6	11.8	12.0	8.7
Construction and mining.....	12.1	6.8	7.5	9.4	10.2	13.3	15.6
Distributive industries.....	9.8	7.8	7.0	9.5	9.0	9.1	8.7
Service industries.....	12.2	9.7	8.3	10.0	11.1	10.8	12.4
Government.....	8.8	10.5	7.7	8.3	8.3	9.1	9.4
Other labor income.....	11.8	13.4	13.7	11.3	10.3	9.3	11.4
Proprietors' income.....	4.7	-4	2.7	3.0	13.6	10.1	21.9
Farm.....	12.6	1.3	1.0	30.2	32.7	21.3	66.4
Business and professional.....	2.0	-1.0	3.7	4.0	6.5	6.0	3.6
Rental income.....	6.6	8.8	2.8	-1.6	4.1	0.1	8.3
Dividends.....	3.0	1.4	1.9	3.6	6.9	4.7	17.0
Interest.....	12.1	13.9	8.2	8.8	12.3	13.0	16.1
Transfer payments.....	10.4	20.3	17.8	10.5	14.1	6.0	11.3

1. Average monthly change expressed at seasonally adjusted annual rate.

It appears that overwithholding will continue indefinitely, as taxpayers have not acted to bring their withholdings into line with their liabilities. Henceforth, however, the flow of overwithholding will be offset by associated refunds.

The rise in consumer outlays matched the rise in disposable personal income in 1973, so that the saving rate (personal saving as a percentage of disposable personal income) was about unchanged from 1972. At 6 percent in the past 2 years, the rate has been

running some 2 percentage points less than the high level maintained in 1970 and 1971. For most of 1973, the saving rate was just under 6 percent, but in the fourth quarter it rose as consumer spending for durable goods declined.

Personal consumption

Personal consumption expenditures increased nearly 11 percent in 1973, compared with 9 percent in 1972. Expenditures for services increased slightly faster in 1973 than in 1972, but most of the acceleration in consumer outlays was in spending for nondurables, which rose 12 percent as compared with 7½ percent in 1972. The speedup in nondurables spending was mainly in outlays for food and petroleum products, where price increases were severe, and in real terms the rise in nondurables consumption was in fact slower in 1973 than in 1972. The rise in durable goods purchases in 1973 was 11½ percent, a large advance but not as large as the 13½ percent increase in 1972; in real terms the slowdown was somewhat sharper. Growth of outlays for automobiles and for furniture and household equipment was slower in 1973 than in 1972, but there was a small acceleration in the growth of aggregate spending for other durables.

There was a phenomenal surge of consumer buying, especially of durables, in the first quarter of 1973, followed by much smaller gains for the rest of the year (chart 11). There were a number of influences that probably contributed to the first-quarter surge. After Phase III of the economic stabilization pro-

gram was introduced in January, fears of price increases apparently led to some buying of items that otherwise would have been bought later in 1973. In addition, many people evidently believed that the mandatory anti-pollution and safety features scheduled for the upcoming 1974 model cars would make them both more expensive and less convenient, and there was unexpectedly strong demand for 1973 models. Also, the ongoing housing boom was still generating increased needs for household equipment. On the income side, the substantial rise in social security benefits in October 1972 was available for spending, and the exceptionally large income tax refunds caused by the overwithholding in 1972 were beginning to be paid. These refunds represented in many cases an unexpected increase in current income, available not only for cash purchases but also as downpayments on big-ticket items bought on credit.

After the first quarter, however, there were a number of developments that probably had an unfavorable impact on consumer's attitudes and hence propensity to spend. The balance of the year saw accelerating price increases and political uncertainties, the outbreak of war in the Middle East, the Arab oil boycott, and growing expectations of a slowdown in the economy and rise in unemployment. Moreover, spending was held down in some cases by shortages on the supply side. This was true of autos and furniture in the spring and summer.

Investment

Capital investment

Business fixed investment in capital goods and structures increased almost \$18 billion, or 15 percent, in 1973. This was somewhat sharper than the rise in 1972, and one of the largest in the postwar period. In real terms, the increase was 10½ percent, also somewhat sharper than in 1972. Last year's acceleration in capital spending re-

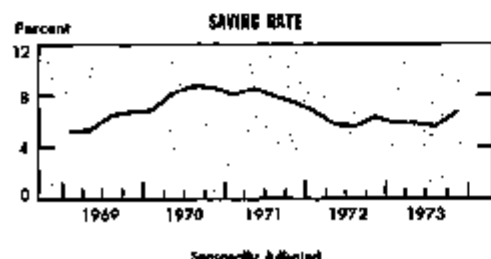
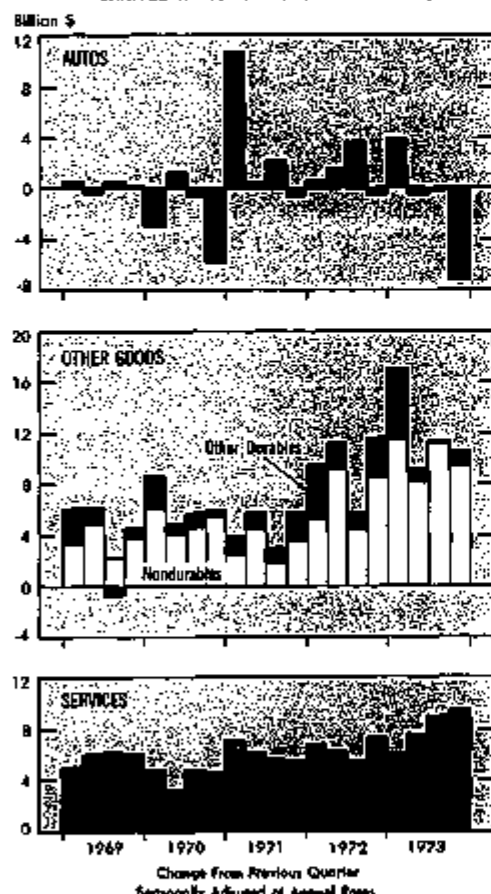
flected the sharp increase in corporate cash flow, the pressures on capacity in many industries, and the need to meet requirements for pollution control and safety.

The acceleration of spending growth was centered in investment in structures, which recorded its first substantial increase in real terms since 1966. The rise in spending for producers'

CHART 11

Consumption and Saving

CHANGE IN CONSUMPTION SPENDING



durable equipment, although large, was smaller in real terms than in 1972. This sort of pattern—accelerating spending for structures and a slowing in the rise of spending for equipment—has been seen also in the advanced stages of past capital investment booms. It may in part reflect the longer lead-time needed in planning and beginning major projects involving structures, and in part a tendency for investment expansions to concentrate first on improving equipment and only later to add new buildings.

Increased spending for industrial structures—a category that is mainly comprised of factory buildings—was responsible for the acceleration of the rise in aggregate investment in structures. Spending for industrial buildings increased by about one-fourth in 1973 after 3 years of decline; despite this

upsurge, and despite the rise in construction costs, the dollar volume in 1973 was still well short of the levels in 1969 and 1970. The relatively low level of industrial building in recent years undoubtedly accounts for some of the pressure on capacity experienced in 1973. Commercial building—stores and offices—has been expanding strongly since 1970; the gain in 1973 was 16 percent, about the same as in 1972.

Industry detail on capital spending is provided in the BEA quarterly survey of business expenditures for new plant and equipment, which has a narrower coverage than business fixed investment in the national income accounts and is also estimated differently. These data show a spending increase in 1973 of 13 percent, compared with 9 percent in 1972. The acceleration of the rise in 1973 was entirely in the manufacturing sector, where outlays rose 21 percent compared with only 4½ percent in 1972 and a decline in 1971. All major manufacturing industries showed considerably larger gains in 1973 than in 1972 except textiles and stone-clay-glass; in these industries, the gains had been very sharp in 1972. Acceleration was marked in both durable and nondurable goods manufacturing with durables up 24 percent in 1973 after a 10½ percent rise in 1972, and nondurables up 18½ percent in 1973 after 2 years of small reductions. Aggregate capital outlays in nonmanufacturing industries rose 8½ percent in 1973, compared with 11½ percent in 1972. The slowdown occurred mainly because of a smaller rise in spending by commercial firms.

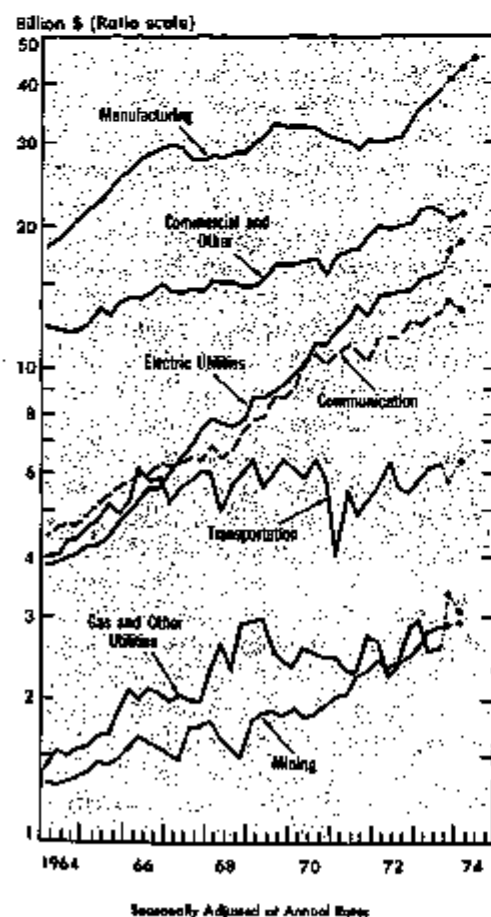
Many manufacturing firms, especially in the basic materials industries, felt a need for more capacity in 1973. Firms holding 51 percent of the gross capital assets in manufacturing reported a need for additional capacity as of September 30, a proportion as high as at the peak in 1966; this proportion has risen steadily from 31 percent in early 1972. By industry, the highest percentages last September were 70 percent in petroleum and 53 percent in chemicals. The rate of capacity utilization in major materials industries, as estimated by the Federal Reserve

Board, has also been rising steadily, from 84 percent in the third quarter of 1971 to 96 percent in the third quarter of 1973, somewhat above the previous peak set in the Korean war period.

At the end of 1973 the available data pointed to continued strong growth in capital outlays. Through the third quarter, the volume of new projects started by manufacturing and public utilities firms remained well above the level of current expenditures so that the carryover of unfinished projects was rising sharply. Similarly, both current capital appropriations by manufacturers and the backlog of unspent appropriations continued to rise in the third quarter, but at a somewhat slower rate than earlier. For 1974, the latest BEA survey shows a planned increase in business outlays for new plant and equipment of 12 percent, against 13 percent in 1973. The gain in aggregate manufacturing outlays is scheduled to slow from 21 percent in 1973 to 17 percent in 1974.

CHART 12

Plant and Equipment Expenditures



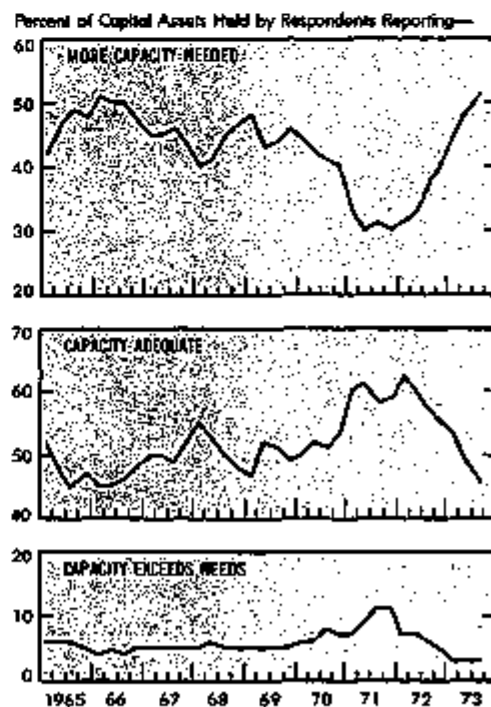
* Expend

U.S. Department of Commerce, Bureau of Economic Analysis

70-11

CHART 13

Manufacturers' Evaluation of Existing Capacity*



* Relative to prospective operations during the ensuing 12-month period.

U.S. Department of Commerce, Bureau of Economic Analysis

70-11

Inventories

While business capital investment was booming last year, business investment in inventories was exceptionally slow. It held at an annual rate of about \$4½ billion in the first three quarters of the year, only about half the pace in the second half of 1972. This low rate appeared to be in good part the result of heavy demand pressures that diverted goods from inventory. Evidence of the difficulties of purchasing goods for inventory is provided in private surveys which show that the

proportion of companies reporting slower deliveries from suppliers and reporting buying commitments for production materials of 60 days or longer both reached the highest levels on record since World War II. The overall ratio of stocks to sales in manufacturing and trade held at around 1.42 months of sales throughout 1973, the lowest ratio for an extended period in over 20 years. In manufacturing, the ratio of finished goods inventories to sales continued to move slowly downward throughout the year in response to the demand for goods, but the ratio of materials and supplies to sales edged upward, suggesting some easing in supply. In retail trade, the ratio also increased slowly during the year from the extremely low level reached in the sales boom in the first quarter.

In the fourth quarter, inventory accumulation increased sharply to an annual rate of \$18 billion. The sharp step-up probably reflected two opposing factors—an unintended buildup as a result of the sharp drop in consumer buying, especially of larger automobiles and recreation vehicles, and a buildup of desired stocks as materials and supplies became increasingly available because of the slowdown of final demand. The evidence on the latter point is still tenuous, however.

Residential investment

Some decline in homebuilding activity in 1973 had been generally anticipated as an adjustment following the record pace of building in 1971 and 1972. The decline was intensified in late summer by sharply rising mortgage interest rates and reduced availability of mortgage financing. By the fourth quarter, starts had fallen 35 percent from the 2.4 million unit rate reached in the first quarter, a very sharp decline; in the 1966 downturn, starts dropped 40 percent over five quarters (chart 14).

For the full year 1973, private housing starts totaled 2.0 million units, down about 13 percent from the 2.4 million in 1972. Starts were down about 13 percent in both single family homes and multiunit structures, to 1.0 million and 916,000 units, respectively.

Mobile homes are an important source of low cost housing but are currently treated in the GNP accounts as durable goods consumption rather than as residential investment. Shipments of mobile homes totaled about 595,000 units in 1973, a bit more than in 1972.

Regionally, the 1973 drop in housing starts were severest in the West, where starts declined some 19 percent. Starts were off about 15 percent in the South, and about 16 percent in the Northeast. In the North Central region, there was a sharp increase in starts early in the year followed by steady decline and the total for the year was about the same as in 1972.

Investment in residential construction was \$58 billion in 1973, up about \$4 billion, or 7 percent, from 1972. The increase occurred entirely in the first half of the year, and was far less than the increases of 26 percent and 37 percent in 1972 and 1971, respectively. In the second half of 1973, residential investment actually declined for the first time since 1970.

Developments within 1973

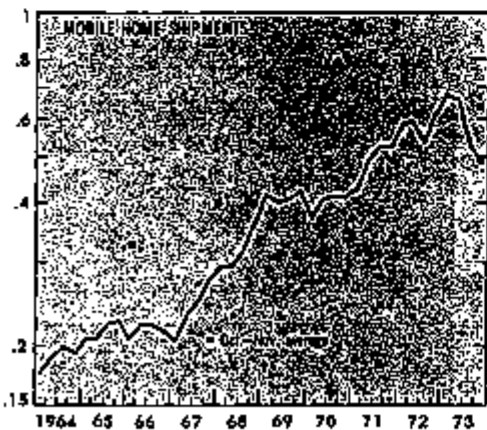
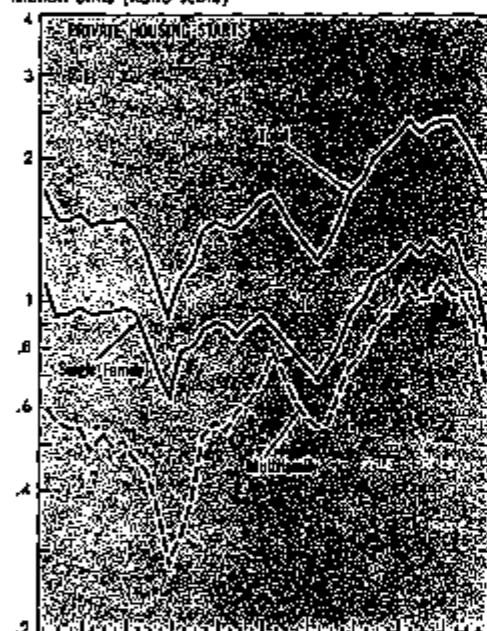
There were several important factors involved in the homebuilding decline in 1973. Some adjustment had been expected because of signs developing already in late 1972 that the housing market was lagging in absorbing the large number of new units coming onto the market; as 1973 progressed, the slowing of absorption became more pronounced. The sales rate of new single-family homes had leveled off late in 1972 and, in the face of rising home prices and financing costs, was already declining in the first quarter of 1973. The stock of homes for sale continued to grow as it had throughout the 1971-72 building boom, and represented an average 7½ months of sales at the average sales rate in the first half of 1973. With tightening mortgage credit, the sales rate for new homes dropped drastically but the stock of unsold homes continued to rise and represented an average 9½ months of sales at the third quarter rate, well above previous high of 6½ months recorded in both 1966 and 1969.

In the rental market, indications of lagging absorption were much less

CHART 14

Residential Construction and Mobile Homes

Million units (Ratio scale)



Seasonally Adjusted or Annual Rates

DATA: Census

14-134

pronounced. The national vacancy rate, which had inched up slowly throughout 1972, was very little higher in 1973, averaging about 5½ percent. Vacancy rates did rise noticeably in the Northeast and the West, but declined in the North Central region. Vacancy rates are expected to continue rising in 1974 because of the very large number of units in multiunit structures which were started some time ago but which are being completed only now. The slowness of the rise in vacancy rates last year may reflect the fact that many large apartment buildings were cooperatives or condominiums and thus never entered the rental market. It has been estimated that in the larger multiunit buildings—those with 5 or more units—10 to 12 percent may have been cooperatives or condominiums.

In addition to the expected adjustments in the wake of the homebuilding boom, there were several important developments in 1973. In January, new commitments under the Federal homebuilding subsidy program were suspended indefinitely. This action resulted in a 45 percent drop from 1972 to 1973 in the number of starts with government subsidy, from 340,000 to about 190,000 units. In addition, there were many new State and local restrictions on homebuilding, including sewer moratoria, environmental impact statement requirements, and so-called "no-growth" policies in some localities. The growing awareness of possible fuel shortages late in the year probably had some effect although the impact in 1973 could not have been large.

Probably the most important single factor in the homebuilding decline in 1973 was the tightening of mortgage credit. Rising short term interest rates led in the summer to a diversion of savers' funds from thrift institutions to market instruments. This resulted in an acceleration of the rise in mortgage interest rates and a sharp reduction in the availability of mortgage funds. In late spring and early summer, mortgage interest rates rose above 8 percent, a crucial level because the usury laws in some 17 States limit interest rates to 8 percent or less. In efforts last summer

to bring the contract rate for Government-backed home mortgages more closely into line with the increased yields in mortgage markets, the ceiling on FHA-VA mortgages was raised in two steps from 7 to 8½ percent. Also, in an attempt to moderate the rise in mortgage rates, the Government National Mortgage Association (GNMA) reinstated the Tandem Plan in September. Under this plan, whenever market

interest rates rise above the ceiling on FHA-insured mortgages, GNMA buys insured mortgages from mortgage lenders at above their market value, thus increasing their attractiveness to lenders and holding down the interest charges to home buyers. Mortgage rates peaked in September, and by November (the latest month for which data are available) had declined between ¼ and ½ percentage point.

Exports and Imports

SPENDING by foreigners for U.S. goods and services increased sharply in 1973, and foreign demand took an appreciably larger share of U.S. output than it had in previous years. A good part of the spending increase reflected higher prices for U.S. output, but the real gain was nonetheless very big. There was sharp expansion not only in U.S. merchandise exports but also in receipts for services. The increase in U.S. spending for foreign goods and services last year was also large, but here, too, higher prices accounted for much of the increase and in real terms the gain was well below that in 1972. The preliminary GNP estimates show goods and services exports in 1973 of \$101.3 billion, up almost \$28 billion or 38 percent, compared with an 11 percent rise in 1972; imports are estimated at \$96.7 billion, up \$18½ billion or 24 percent, compared with a 19 percent rise in 1972. The estimated balance on goods and services—the net export component of GNP—was in surplus by \$4.6 billion last year, compared with a deficit of \$4.6 billion in 1972. The surplus was the largest since 1967.

The balance on goods and services improved quarter by quarter through the year, although the preliminary estimate for the fourth quarter shows only a modest advance, reflecting an apparent slowdown in the improvement of the merchandise trade balance. Toward yearend, rising prices of petroleum imports were inflating the value of merchandise imports, even though the volume of petroleum imports was being dampened as a result of the oil boycott.

There were several major factors behind the swing last year to a surplus in merchandise and service transactions. The more or less coincident timing of booms in major world economies stimulated demand for U.S. output, especially for machinery and for materials such as lumber and metals. Poor harvests abroad were a major stimulus to demand for agricultural commodities. Another factor, but one whose quantitative importance is not clear, was the incentive to export that was provided in some cases by the domestic price control program, as exports were not subject to control. Changes in relative prices—reflected in faster rising import than export prices—served to reduce the attractiveness of foreign output to U.S. buyers and to increase the attractiveness of U.S. output to both domestic and foreign buyers. These changes in relative prices reflected the effects of the dollar devaluations in December 1971 and February 1973, augmented until the autumn of 1973 by further exchange market depreciation of the dollar relative to leading currencies. In addition, price inflation was generally faster abroad than in the United States. Indeed, given the steep rise in the dollar prices of foreign goods and services, it is rather surprising that the total dollar value of imports did not rise more than it did last year; to put it another way, the growth in the real volume of imports slowed to a surprising degree.

Merchandise trade

Detail on merchandise trade is available only for the first three quarters of

1973. In that period, exports were up 41 percent from the comparable 1972 period and imports were up 25 percent; the increases in 1972 over 1971 were 14 percent and 22 percent, respectively.

Agricultural exports increased 86 percent last year, with about half of that rise due to higher prices and half to real volume. The bulk of the increase went to traditional markets, with shipments to China and the U.S.S.R. accounting for only about 15 percent of the advance. Nonagricultural exports increased 31 percent, with most of the advance reflecting real growth rather than higher prices. There were especially sharp gains in exports of industrial supplies and materials—notably metals, chemicals, logs, and lumber—reflecting strong economic expansion abroad and probably some diversion to avoid domestic price controls. Other export categories—capital goods, autos, other nonfood consumer goods—also increased substantially.

Among major import categories, the largest percentage rise last year was in capital goods. The value of petroleum imports increased substantially, reflecting higher volume as well as higher prices. Imports of other supplies and materials also rose quite rapidly. The substantial rise in food imports was in good part attributable to higher prices.

Services

The nonmerchandise accounts also improved sharply in 1973. Foreigners' purchases in nonmerchandise—"services"—transactions increased 28 percent from the first three quarters of 1972 to the same period last year, compared with a 5 percent increase in 1972. U.S. imports of services increased 17 percent in 1973, compared with 12 percent in 1972. The balance in each major service account improved last year. The military transactions deficit shrank as defense spending abroad edged down while U.S. military aircraft sales increased substantially. The deficit on travel and transportation also fell, for the first time in 4 years. U.S. receipts of income from investment abroad were spurred by strong economic growth abroad and by the dollar's depreciation (which meant that a given amount of

Table 6.—Exports as Share of U.S. Production, Imports as Share of U.S. Domestic Demand

[Percent]						
	Average		1970	1971	1972	1973*
	1960-64	1965-69				
Exports						
1. Goods and services.....	8.6	5.8	8.4	8.3	6.4	7.6
2. Goods.....	7.6	7.3	8.9	8.6	2.0	11.1
Imports						
3. Goods and services.....	4.6	5.3	5.1	6.2	6.7	7.4
4. Goods.....	4.8	5.9	7.0	7.4	8.2	9.1
5. Autos.....	2.1	5.9	11.4	11.7	12.3	12.1
6. Nonautomotive capital goods.....	3.0	3.6	7.4	8.2	10.1	11.9
7. Food.....	4.2	4.3	4.7	4.7	5.0	5.8
8. Nonfood, nonauto consumer goods.....	2.4	3.6	4.6	4.9	5.9	6.0
9. Industrial supplies and materials.....	2.6	2.6	2.7	2.8	3.0	3.5

*First 3 quarters.

Note.—Exports and import data used in lines 1-4 of this table are as published by BEA in lines 1, 2, 16, 18 of table 3 of the regular balance of payments tables. The imports used to calculate lines 5-9 of this table are, respectively, those shown on lines 24, 26, 31, 37 and 40 of balance of payments table 4. The denominators of the ratios shown here are, by line number: (1) GNP; (2) goods components of GNP; (3) GNP less net exports; (4) goods and structures components of GNP less net merchandise exports; (5) gross auto products less its net export component; (6) producers' durable equipment less autos, trucks, buses; (7) personal consumption spending on food; (8) personal consumption spending on goods except food, autos, and gasoline; (9) goods and structures components of GNP less net merchandise exports.

income in many foreign currencies was worth more in dollars in 1973 than previously). The rise in receipts was large enough to boost the U.S. net surplus on investment income even though U.S. payments of investment income rose rapidly.

Export and import shares

When the balance on goods and services was deteriorating in the 1960's, the share of imported goods and services in U.S. domestic demand increased substantially but there was only a slow rise in the share of U.S. output exported. The improvement of the balance in 1973 occurred as the import share in domestic demand increased further but the share of output exported rose sharply, especially the share of goods output exported. Table 6 shows these share figures, with some detail on the relation of imports to domestic demand. The table shows stabilization of the import share in domestic spending for autos and other nonfood consumer goods, but a continued rise in other categories.

There is little reliable information about international trade in constant prices, and the shares in table 6 are calculated from current-price data. The trends over past years would probably be quite similar if calculated in constant prices (i.e., in real terms), but this was undoubtedly not true of the

import share in 1973. All evidence indicates that the rise in import prices was much faster last year than the rise in the average price of all goods and services purchased in the United States. Thus, in real terms the share of imports in U.S. domestic demand probably did not rise at all last year, and may have fallen.

Government

GOVERNMENT purchases of goods and services amounted to \$277 billion in 1973, a gain of \$22 billion from 1972. Federal purchases increased \$2½ billion and State-local purchases were up about \$20 billion.

Other Federal expenditures, mainly transfer payments, increased nearly \$18 billion. Federal receipts increased almost \$37 billion, and the Federal fiscal position on the national income accounts basis shifted from a \$16 billion deficit in 1972 to a small surplus in 1973. Since part of this swing resulted from an expansion in economic activity, the shift toward restraint in the "full-employment" budget was somewhat less. Unofficial estimates indicate that the "full-employment" budget (NIA basis) swung from a \$6 billion deficit in 1972 to an \$8½ billion surplus last year. (In this calculation, overwithholding and the associated refunds were not considered to be the result of

tax law changes, and thus had no effect on changes in "full-employment" revenues.)

The large swing in the actual fiscal position largely reflected the impact of

inflation and a booming economy on corporate and personal income taxes, as well as increases in the rates and the earnings base for social insurance contributions. Federal expenditures grew at about an 8 percent rate, about the same as in 1971 but below the 10 percent recorded in 1972.

Defense purchases in 1973 were down slightly from the previous year, despite a \$1.6 billion increase in payroll costs that was due largely to pay raises for military and civilian personnel effective in January and October. The aggregate of other defense purchases declined about \$2 billion, mainly in procurement of military hard goods. Heavy arms sales to Israel in the fourth quarter, which are netted against gross defense purchases, accounted for nearly \$0.6 billion of that decline.

Nondefense purchases increased \$2.6 billion, much less than the increases of \$4.9 and \$3.6 billion in 1971 and 1972, respectively. Net interest payments to foreigners were a major factor in last year's increase, rising \$1.3 billion. (Government interest payments to foreigners are treated in the GNP accounts as a Government purchase, but also as an import of services, and thus their amount has no effect on the size of GNP.) The remaining advance was only \$1.3 billion because of a sharp decline in net purchases by the Commodity Credit Corporation, associated with the surge in agricultural commodity prices, and because of a somewhat smaller-than-normal increase in purchases by other agencies.

Among the spending categories other than purchases of goods and services, transfer payments to persons again registered an exceptionally large increase—\$13 billion. Social security and medicare benefits, boosted by recent legislation, accounted for nearly \$11½ billion of that advance: social security benefits were raised 20 percent across-the-board in October 1972, and medicare benefits were extended to disabled persons under 65 in July 1973. A larger-than-usual increase in the number of recipients, plus cost-of-living adjustments, resulted in large increases in retirement benefits in a number of other transfer programs affecting retired Federal civilian and military

personnel and retired railroad workers. Rising interest rates were the major factor in the \$2.4 billion advance in net interest paid (other than to foreigners). Grants-in-aid increased \$3.5 billion; subsidies declined \$0.7 billion.

Large advance in contributions

The exceptionally large increase in Federal receipts last year—\$37 billion—was paced by a \$17 billion advance in social insurance contributions, including \$15 billion in OASDHI contributions and \$1.5 billion in employer contributions to the unemployment insurance program. Over \$10 billion of the OASDHI advance is attributable to the January 1, 1973 increase in the combined employer-employee tax rate from 10.4 percent to 11.7 percent, and the boost in the earnings base from \$9,000 to \$10,800. (The base was increased again—to \$13,200—on January 1, 1974.)

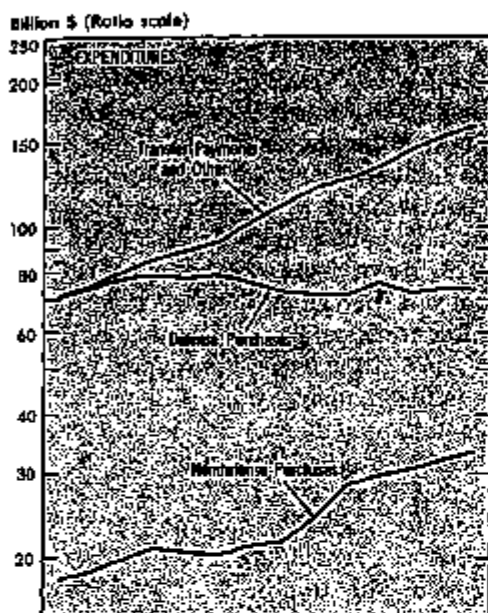
Corporate taxes advanced nearly \$12 billion, reflecting the \$28.5 billion increase in corporate profits before taxes. Indirect business taxes increased about \$1 billion. Despite the sizable increase in personal income last year, personal income taxes rose only \$6.6 billion. This was because of large income tax refunds attributable to heavy overwithholding in 1972: increases in withheld taxes (\$13 billion) and nonwithheld taxes (\$1.5 billion) last year were significantly offset by an \$8 billion increase in refunds. There were no indications in 1973 that individuals were lowering withholding payments to match liabilities. Thus, heavy overwithholding continued last year and will apparently persist, with the result that future refunds will remain at, or above, their 1973 levels.

Higher State-local payrolls

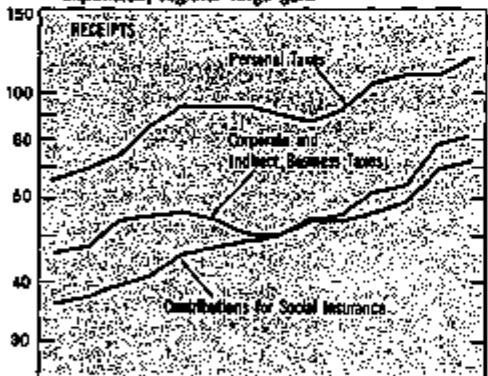
Higher payroll costs accounted for about half of the \$20 billion increase in State and local purchases last year. Approximately one-fifth of the increase was accounted for by capital purchases—for structures and equipment—which advanced more rapidly than in recent years. Spending for structures increased about \$2 billion, following no growth in 1972 and increases of only

CHART 15
Federal Budget (NIA Basis)

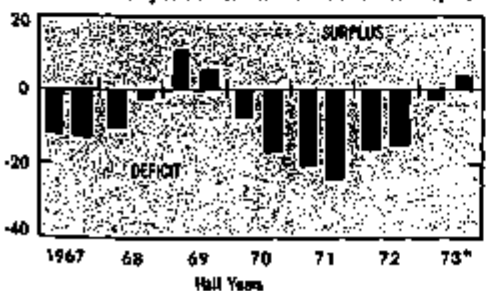
Transfer payments advance, defense purchases level off



* Receipts, boosted by inflation and economic expansion, register large gain



* The fiscal position shifts from deficit to surplus



Seasonally Adjusted at Annual Rates

* Data for second half are preliminary

U.S. Department of Commerce, Bureau of Economic Analysis

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\$1.2 billion in 1971 and \$0.2 billion in 1970. There were especially large gains last year in spending for public transit and waste treatment facilities. The acceleration in equipment purchases is probably due to the manner in which revenue-sharing funds have become available. To many governments, the first distributions, in late 1972 and early 1973, appeared as unexpected revenue and resulted in much larger than normal "one-time" purchases, especially of equipment. Later revenue-sharing distributions were more generally considered in the normal budget process, and are not expected to have the same impact.

The rate of increase in State-local transfer payments continued to decelerate last year. For transfers taken as a whole, the 1973 increase was three-quarters of the previous year's advance. Almost all of this slowdown was in welfare payments, where growth was small during 1973.

The largest component of welfare payments, aid to families with dependent children (AFDC) grew by only about 4 percent in 1973, following an average annual growth rate of over 18 percent in the period 1960-71 and a more modest rate of growth of about 12 percent in 1972. The earlier increases were for the most part generated by a rising level of benefits and by a growing awareness on the part of potential recipients of their eligibility for public assistance payments. As the pool of potential recipients declined, so did the rate of growth of expenditures for welfare. Another factor in the recent slowdown was the imposition of more stringent welfare regulations in several large states.

Slower growth in receipts

Despite the booming economy, total State-local receipts increased at a slower pace than in 1972 (table 7). Growth in

Table 7.—State and Local Government Receipts, Change From Previous Year
(Billions of dollars)

	1973	1972
Total receipts.....	24.8	27.4
Receipts from own sources.....	16.3	14.2
General revenue sharing.....	2.0	1.1
Federal grants-in-aid, except general revenue sharing.....	5.9	-1.0

receipts from their own sources slowed, and Federal grants other than general revenue sharing actually declined slightly. Federal budget stringency, particularly for the first three quarters, held down these grants. However, the growth in general revenue sharing, which began only in late 1972, more than exceeded the decline in other grants. The slowdown in the growth of "own

source" revenue is largely due to the relative absence of tax increases in 1973; higher tax rates and the imposition of new taxes have been a major factor in State-local revenue growth for many years. In addition, special one-time factors, associated with advance payments in 1972, temporarily reduced the 1973 level of public assistance grants.

Labor Force and Employment

EMPLOYMENT growth in 1973 was even stronger than in 1972, when the gain was one of the largest since World War II. For the full year 1973, civilian employment (as measured by the monthly survey of households) increased 2.7 million, or 3.3 percent, compared with 2.3 million, or 2.9 percent, in 1972. The civilian labor force rose 2.2 million in 1973, compared to 2.1 million in 1972, and the unemployment rate fell substantially. The rate averaged 4.9 percent in 1973, down from 5.6 percent in 1972 (table 8). In the closing months of the year, however, employment growth stopped and the unemployment rate rose. This was a reflection of the general slowing of the economy's growth, but the oil boycott may also have been having some impact at yearend.

The employment expansion in 1973 was especially strong in manufacturing, particularly in durable goods industries such as primary metals and machinery. The rate of unemployment among workers whose last industry attachment was to durables manufacturing dropped from an average 5.4 percent in 1972 to 3.9 percent in 1973, the lowest rate

since 1969. Among occupational groups, the unemployment rate fell sharply for the blue-collar workers, especially operatives, for the second year in a row; the blue-collar rate was 5.3 percent for 1973, down from 6.5 percent in 1972 and 7.4 percent in 1971. For white-collar workers, unemployment declined in 1973 to 2.9 percent after holding around 3.5 percent in 1972 and 1971. Unemployment also fell for the major age-sex groups. The drop in the unemployment rate for adult men presumably reflects the expansion in industries which are heavy employers of men. The drop in the unemployment rate for teenagers was much greater in 1973 than in 1972, when the supply of unemployed workers with experience was greater.

Evidence of the strength of demand for labor in 1973 is provided by the rise in labor force participation. The rise was concentrated among adult women, whose participation tends to be quite sensitive to labor market conditions. Women's participation in the labor force has been rising over the long term at a substantial rate, but that trend was interrupted by very

Table 8.—Unemployment Rates

(Percent; half-years seasonally adjusted)

	1969	1970	1971	1972	1973	1st half 1973	2d half 1973
Total.....	5.5	4.9	4.9	5.6	4.9	5.0	4.7
Adult men.....	2.1	2.5	4.1	4.0	3.2	3.4	3.0
Adult women.....	8.7	4.8	5.7	6.4	4.8	4.9	4.8
Teenagers.....	12.2	15.3	16.9	16.2	11.6	14.6	14.4
Selected industries: ^a							
Durables manufacturing.....	3.6	5.7	7.0	6.4	3.9	4.2	3.6
Nondurables manufacturing.....	3.7	5.4	6.5	5.7	4.9	5.1	4.7
Construction.....	6.0	3.7	10.4	10.3	8.8	8.8	9.1
Transportation and public utilities.....	2.3	3.2	3.8	3.6	3.0	3.0	2.0
Trade.....	4.1	5.3	6.4	6.4	4.6	5.6	5.3
Finance and services.....	3.8	4.2	3.1	4.8	4.3	4.4	4.2
Government.....	1.9	2.2	2.6	2.9	2.7	2.7	2.8

^aWage and salary workers only.

small increases in 1971 and 1972. In 1973, however, as labor market conditions became much tighter, women's participation increased sharply. Nevertheless, the rise in employment of women was enough to lower their unemployment rate appreciably. The labor force participation rate for men continued its slow secular decline last year.

Nonfarm payroll employment

The number of employees on the payrolls of nonfarm establishments, as measured by the monthly payroll survey which provides detail on employment by industry, increased 2.8 mil-

Table 9.—Percent Change in Nonagricultural Employment by Industry

	1969	1970	1971	1972	1973	1973 ¹	
						1st half	2nd half
Total	2.5	4.4	0.1	4.8	1.9	4.1	3.6
Durables manufacturing	2.3	-0.2	-5.6	3.0	5.9	4.7	3.7
Nondurables manufacturing	1.4	-1.4	-2.3	1.2	1.7	1.7	1.0
Contract construction	4.0	-1.0	-3.4	3.7	3.5	11.1	5.4
Mining	2.1	1.0	-3.4	1.2	2.0	7.2	1.5
Transportation and public utilities	2.2	1.4	-1.1	1.6	2.6	1.7	1.5
Trade	2.9	1.8	1.6	2.6	2.9	2.9	2.4
Finance	4.4	3.5	2.9	2.5	3.2	2.6	2.5
Services	4.7	3.4	2.2	3.7	4.5	4.5	4.7
Government	3.0	2.7	2.6	3.4	2.7	2.3	2.6

1. Average of monthly change expressed at seasonally adjusted annual rate.

lion, or 3.9 percent, between 1972 and 1973. The larger part of that increase came in the first half of the year, as slower employment gains in the second half of the year reflected the general slowdown of growth in the economy. The gain from 1971 to 1972 was 2.1 million, or 3 percent. Employment in durable goods manufacturing, which constitutes about 15 percent of total payroll employment, accounted for 26 percent of the 1973 increase. The overall rise in durables employment was about 7 percent (table 9), with the sharpest advances occurring in non-electrical machinery (over 9 percent) electrical equipment (9 percent), and instruments (8½ percent), reflecting strong demands for capital goods. Employment in the transportation equipment industry, which was up about 6½ percent for 1973 as a whole, rose strongly in the first half of the year but then declined, reflecting the early strength and later easing of demand for automobiles. Employment growth in primary metals, on the other hand, accelerated in the second half of the year as producers attempted to work down a large backlog of orders; the gain for the full year was about 6½ percent. Employment in nondurable goods industries increased only a little in 1973; the exception to the pattern was in rubber and plastics, where employment increased close to 9 percent.

The manufacturing workweek averaged 40.7 hours in 1973, about the same as in 1972. The workweek lengthened early in the year, reflecting an increase in hours in the transportation equipment industry. After the spring, the average manufacturing workweek declined somewhat and then leveled off,

as a shortening of hours in transportation equipment was offset by a lengthening of the workweek in other durable goods industries. Toward yearend, there were substantial increases in the workweek in the primary metals and petroleum industries, reflecting heavy demand for their output.

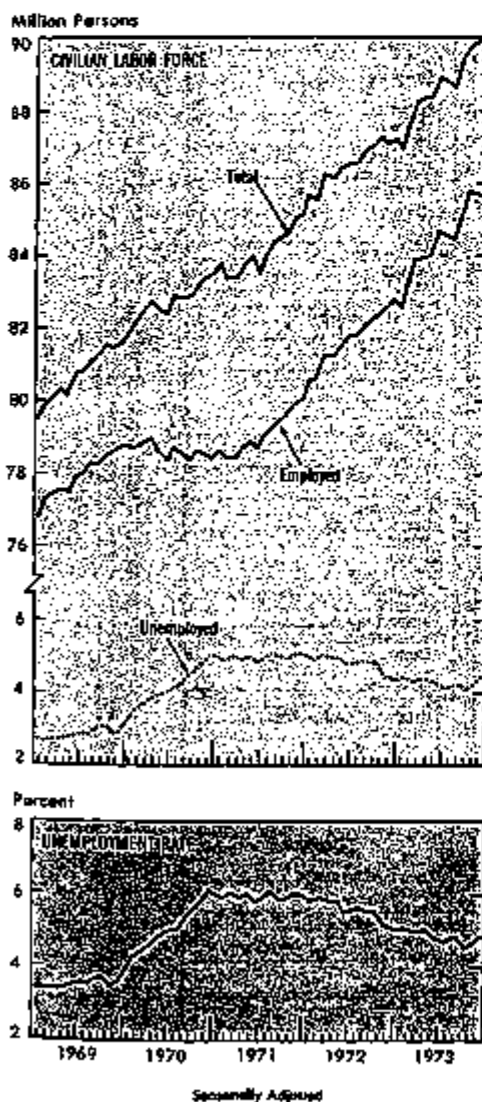
Tightness in the supply of factory labor in 1973—especially in the first half of the year—is indicated by job vacancies and labor turnover. Vacancies for the full year averaged nearly 50 percent higher than in 1972, although they stopped rising after midyear. The layoff rate declined in the early months of 1973 and then stabilized at the lowest point since World War II, and the quits rate—which is sensitive to worker expectations about the chance of finding a better job—increased to the same high level as in 1969.

In other goods-producing industries, employment in mining rose only slightly but construction employment rose at about the same strong rate as in 1972. Most of the increase in construction employment was in the first half of the year; the slower growth of employment in the second half reflected principally the decline in residential construction.

Employment in the service-producing sector increased at a fairly steady pace in 1973, rising 1.7 million, or 3½ percent for the year, about the same as in 1972. Employment in wholesale and retail trade, which accounts for about one-third of all service employment, rose about 4 percent, a bit faster than in 1972. The rise in State and local government employment slowed from about 4½ percent in 1972 to about 3½ percent in 1973, mainly because of reductions in school employment.

CHART 16

Employment and Unemployment



Ref: BLS